Fossy logic

Is the FOS a workable adjunct to an already creaky legal system or is it a monster, out of control and careering across the financial services landscape doing immeasurable harm? Alan Lakey, partner of Highclere Financial Services highlights adviser concerns

The answer to whether the procedures of the Financial Ombudsman Service (FOS) are fair and reasonable is likely to depend on whether you are an adviser, a consumer or a regulator.

"FOS is an unusual creature. One that I suggest Parliament would not have dared to create had the groundwork not been laid by a series of voluntary initiatives. It is a one-sided scheme offering an unlevel playing field broadly supported by those playing up hill" – these are the words of Chief Ombudsman Walter Merricks at a speech that he gave to Cardiff Faculty of Law in October 2002.

This admission by Walter Merricks will dismay advocates of democracy. FOS derives its powers from the Financial Services Authority (FSA) which sets out the parameters within the Dispute Resolution Rules (Disp.2). FOS is not subject to the Freedom of Information Act and, apart from acts of 'bad faith' and a breach of the Human Rights Act (HRA); it enjoys immunity from legal action.

Does FOS disregard the law?

The dictum "he who asserts must prove" forms the basis of English Law and was also established within the procedures of predecessor body, the Personal Investment Authority Ombudsman Bureau (PIAOB). Thanks to the Financial Services and Markets Act 2000 (FSMA) FOS allows no such proximity to the law as is evidenced by the current standard adjudication response paragraph: "Where there is a dispute about what happened, we base our decisions on the balance of probabilities – in other words, on what we consider is most likely to have happened in the light of the evidence". This fundamental change enables FOS subjectivity to replace any previous vestiges of objectivity.

FOS also ignores a firm's right to cross-examine the complainant and evaluate all evidence as sanctioned within the court system. It is proud of its ability to cut through what it considers to be irrelevancy. "Our authority entitles us to go straight to the evidence we know to be relevant", said Merricks in a speech to the British & Irish Ombudsman Association in May 2004.

However not only are established legal procedures ignored but also the law itself. Individuals and firms enjoy protection under The Limitation Act 1980, as amended by the Latent Damage Act 1986. This provides a 15 year longstop after which claims for negligence cannot be pursued. Unlike its predecessor, FOS denies this legitimate protection arguing that FSA time-barring rules take precedence, although it then confesses to being unsure: "There is no such limitation in the rules that the FSA made for the ombudsman and the FSA has recently made it clear that it has no intention of altering that", said Merricks in a speech to the Council of Mortgage Lenders in December 2003. Conversely, FOS has no compunction in quoting the relevant Partnership Law when chasing the spouses of deceased advisers to recover case fees even when they have been exonerated from mis-selling claims.

FOS contends that the FSMA makes no reference to the 15 year longstop. The FSA concedes that it is subject to English Law yet the provisions within Disp.2 clearly show that it is able to create new law without reference to parliament or the courts. Both the FOS and the FSA can ignore statutory law and generate new law, or apply variations of existing law, at their behest.

As Simon Orton, partner at Freshfields Bruckhaus Deringer said, of the judicial review for IFG Financial Services in May 2005, "It is one thing for the FOS to depart from the law where it is unclear or does not properly address a situation, but the proposition that it can simply ignore an important legal principle – and, significantly, that there is no check on it if it does so – is quite concerning.

The benefits of the FOS come at the expense of depriving the defendant firm of the procedural and substantive protections it would have under the formal court system. It is therefore particularly important that the system should be reasonably predictable and be subject to appropriate checks and balances.

The principle of legal certainty requires that firms should be able to manage their customer relationships and their risks in a reasonably predictable legal and regulatory environment. This may be difficult to achieve where the Ombudsman can, in effect, disregard the law".

Are FOS procedures fair and reasonable?

As Walter Merricks said in 2002, "In determining complaints FOS should take into account legal rights and industry codes, but should decide on the basis of what is fair and reasonable". And then again, in evidence to the Treasury Select Committee in June 2004, FOS revels in its ability to work outside the parameters and principals of established law, asserting, "We comply with the rules of natural justice".

FOS was established as an efficient and cost-effective alternative to the courts, but efficiency and cost-effectiveness could result in hurried conclusions and corner-cutting. Both of these may serve to deliver injustice and injustice is never fair and reasonable.

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